Flash Economics

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Structurally high inflation or structural disinflation?

There are arguments in both directions: in favour of the chronic inflation hypothesis and in favour of the structurally low inflation hypothesis.

Those who favour the high inflation hypothesis point to the widespread scarcity of raw materials, energy and labour.

Those who favour the low inflation hypothesis put forward the excess production capacity in China and the increase in the population entering the labour market in India as arguments in support of their thesis.

Whether to favour the high or low inflation hypothesis depends on:

- The time horizon; in the short term, excess production capacity in China will maintain zero inflation for industrial products;

- The reaction of Western countries; if they protect themselves from competition from Chinese manufacturers by imposing tariffs, then there will be inflation in the OECD countries and deflation in China;

- Productivity gains, high in the US (which weakens structural inflation), zero in Europe (which increases structural inflation).

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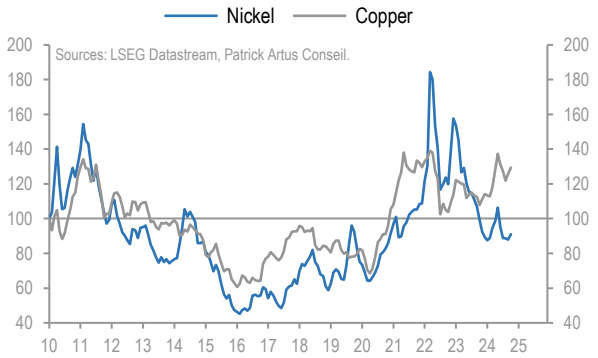
Two views on future inflation

Some economists favour the hypothesis that **chronic inflation will appear in the future**, while others support the idea that the world will enter a situation of **deflation**.

1. **Those who favour the inflation hypothesis** point to the emergence of a situation of generalised scarcity :

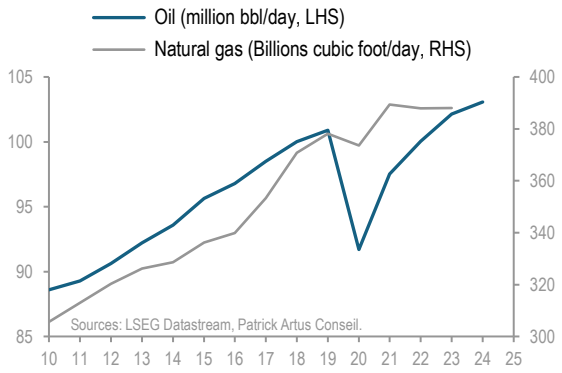
   - a **shortage of raw materials** (hence the price rises observed for copper and nickel, for example, **Chart 1**);.

Chart 1
Metal prices (01.01.2010 = 100)



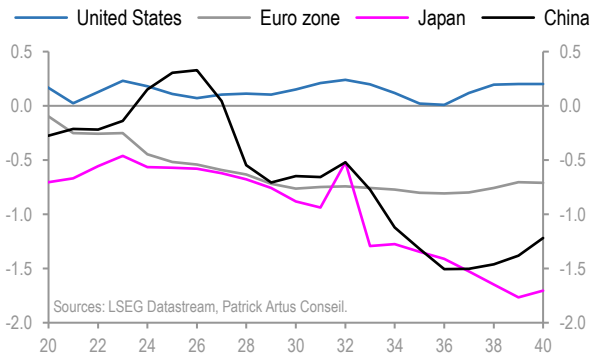
   - **of energy**, with a halt to the use of fossil fuels necessary to avoid a rise in temperature (**Chart 2**);

Chart 2
World: Oil and natural gas consumption



   - **of labour**, as the working-age population falls (**Chart 3**).

Chart 3
Population aged 15 to 64 (as % per year)



This situation of widespread scarcity would push up wages, commodity and energy prices, and hence inflation.

2. **Those who favour the hypothesis of structurally low inflation** point to **the existence in China of significant excess capacity** (in steel, aluminium, cars, electric batteries, solar cells, wind turbines, etc. (**Chart 4**)), which has led to the emergence of **a large exportable surplus**, driving down the prices of industrial products in China (**Chart 5**) and in other countries (**Charts 6A/B**).

Chart 4
China: Capacity utilization for manufacturing (as %)

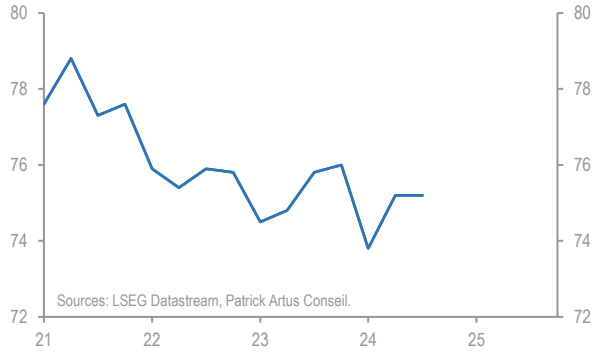


Chart 5
China: Consumer price index of goods and producer price index for manufacturing (Y/Y as %)

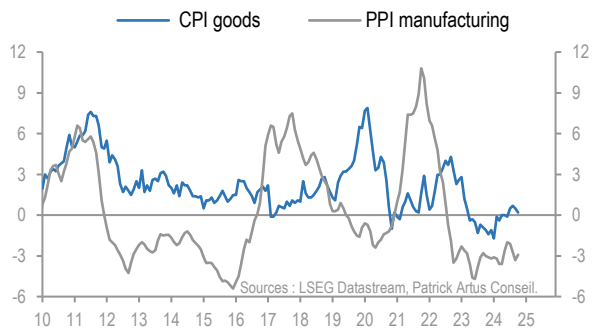


Chart 6A
Consumer price index of nonenergy industrial goods (Y/Y as %)

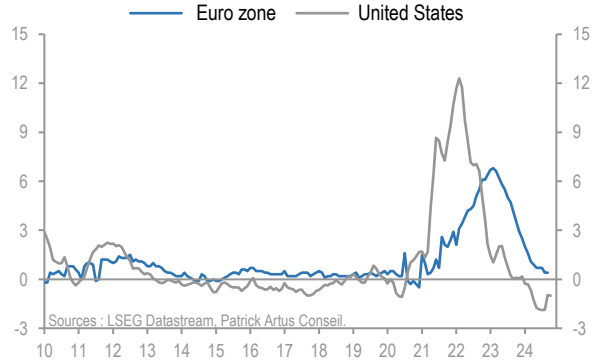
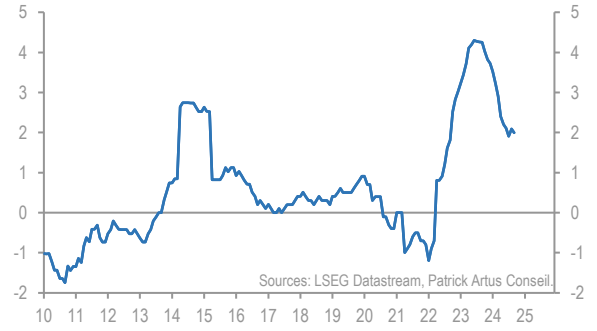
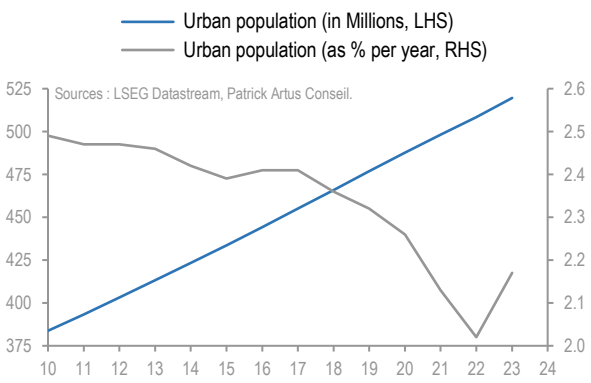


Chart 6B
Japan: Consumer price index excluding fresh food and energy (Y/Y as %)



They also point to the **possibility of increasing the number of people entering the labour market to obtain paid employment** in many emerging countries, particularly India (**Chart 7**).

Chart 7
India: Urban population

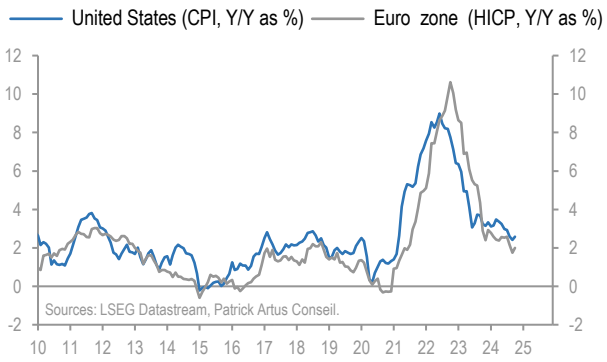


High or low inflation: which hypothesis should be favoured?

We believe that the choice between high and low inflation depends on:

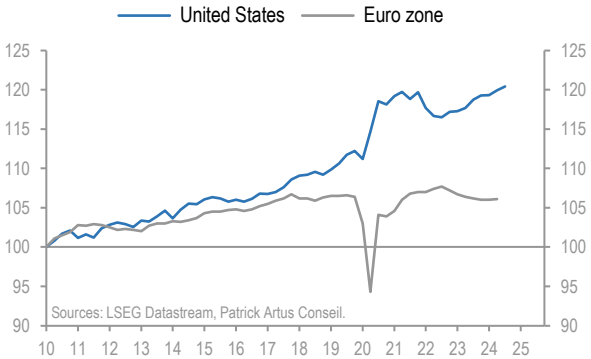
- **The time horizon selected;** in the short term, excess production capacity in China and the possibility of increasing urban employment in India will maintain zero inflation for industrial products (**Charts 6A/B**), and therefore low overall inflation (**Chart 8**).

Chart 8
Inflation (as %)



- **The reaction of Western countries to imports of Chinese products**. If they protect themselves from competition from Chinese manufacturers by imposing tariffs, then there will be **inflation in the OECD countries and low inflation or even deflation in China;**
- **The level of productivity gains**: if they are high (USA), inflation is reduced; if they are zero (Europe, **Chart 9**), inflation is higher.

Chart 9
Productivity per capita (2010.Q1 = 100)



Summary: In the end, high or low inflation?

If we think that Western countries will protect themselves from Chinese products, we conclude that the high inflation hypothesis is more likely than the low inflation hypothesis, especially in Europe due to the absence of productivity gains.

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